IN THE

Supreme Court of the United States

October Term, 1941.

No. .....

GEORGE T. GOGGIN, as Trustee in Bankruptcy of the Estate of Acme Traffic Signal Company, a corporation,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The opinion of the District Court appears at page 2 of the record. See, also, 37 Fed. Supp. 352, 45 A. B. R. (N. S.) 346.

The opinion of the Ninth Circuit Court of Appeals appears at page 40 of the record. See, also, C. C. H. Bankruptcy Service, page 53,768, paragraph 53,479.

The Referee did not file an opinion.

II.

Jurisdiction.

Jurisdiction herein is predicated upon Judicial Code, Section 240-a, as amended by the Act of February 13, 1935, Chap. 229, Section 1, 43 Stat. 936.

Reference is made, also, to Rule No. 38-5-(b) of the Supreme Court, wherein is specified some of the reasons

which will be considered by the Supreme Court in the exercise of its sound judicial discretion with respect to the issuance of writs of certiorari.

III.

Statement of the Case.

This has been covered under headings Nos. I and II in the foregoing petition for the writ of certiorari. For the sake of brevity the statement is not repeated here.

IV.

Specification of Errors.

The following are assigned as errors in connection with the judgment of the Ninth Circuit Court of Appeals made on November 18, 1941:

(1) Its holding that the determination of an adjusted capital stock tax by the Collector of Internal Revenue. based upon a concededly false value, cannot be reviewed and revised by the Bankruptcy Court, either under Section 64-a-(4) or Section 62-a of the Bankruptcy Act.

(2) Its holding that such a tax, so ascertained, is the same as any other obligation owed by the debtor or bankrupt at the time of the commencement of the bankruptcy proceedings; and that the debt itself cannot be reviewed and revised under the general equity powers of the Bankruptcy Court and its control over claims filed against the bankrupt estate, to ascertain whether such tax is a just debt against the estate.

(3) Its holding, in effect, that the declared capital stock value by the bankrupt, prior to bankruptcy, even though false, is irrevocable and binding upon the Bankruptcy Court.

V.

ARGUMENT.

POINT 1.

Bankruptcy Courts Have Ample Power to Review and Revise Tax Claims, Whether They Arise Before Bankruptcy or Afterward.

Tax claims arising before bankruptcy are properly claims against the estate and subject to Section 64-a-(4). Bankruptcy Act, Sec. 57-n; *City of New York v. Feiring,* 45 A. B. R. (N. S.) 643, 85 L. Ed. Adv. Op. 892. Tax claims arising after bankruptcy are properly expenses of administration and subject to Section 62-a.

Missouri v. Earhart (C. C. A. 8), 111 Fed. (2d) 992;

In re Cal. Pea Products (D. C. S. D. Cal.), 37 Fed. Supp. 658, 45 A. B. R. (N. S.) 393;

In re Lambertville Rubber Co. (C. C. A. 3), 42 A. B. R. (N. S.) 697, 111 Fed. (2d) 45; and

Columbia Ribbon Co. (C. C. A. 3), 117 Fed. (2d) 999, 45 A. B. R. (N. S.) 528.

The Bankruptcy Act appears to give the Bankruptcy Court ample control over such claims. Section 2-a-(2) provides that the Bankruptcy Court has jurisdiction to

> "Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates."

Section 64-a-(4), relating to debts which have priority, provides:

> "That, in case any question arises as to the amount of legality of any taxes, such question shall be heard and determined by the court."

Section 62-a, relating to expenses of administering estates, provides:

> "The actual and necessary costs and expenses incurred by officers in the administration of estates shall . . . be . . . examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred."

Also, it would seem that a tax claim, state or federal, would have no higher standing as a claim than a judgment by a court of competent jurisdiction. In the exercise of its general equity powers the Bankruptcy Court, at least in the absence of a plea of *res judicata*, can go behind a judgment claim to ascertain whether the underlying debt is just and equitable.

> *Pepper v. Litton*, 308 U. S. 295, 85 L. Ed. 281, 41 A. B. R. (N. S.) 279.

POINT 2.

The Fact That the Federal Statute Makes Irrevocable a Declaration of Capital Stock Value by a Taxpayer Does Not Preclude the Bankruptcy Court From Adjusting the Tax From the Point of View of Whether or Not Such Declared Value Is the True Value.

In the instant case it was the contention of the federal government, upheld by the Circuit Court of Appeals, that, since the statute (Sec. 1202-a-(2) of the Internal Revenue Code) does not permit any amendment by the taxpayer of a capital stock value once declared by him, or, in other words, such declaration is irrevocable, the Bankruptcy Court is helpless to go behind this declared value, ascertain the actual value, and allow or disallow the tax claim accordingly.

In our case, in the District Court, Judge McCormick said:

> "The purpose of establishing an irrevocable adjusted declaration of value by a corporate taxpayer as the basis of its capital stock tax is to protect the government from avoidance by the taxpayer of just capital stock taxes and the interrelated excess profits tax, as well. See *Chicago Telephone Supply Co. v. United States* (Court of Claims), 23 Fed. Supp. 471."

As further stated by Judge McCormick in his opinion:

> "It is impossible for this bankrupt to avoid any taxes which it is reasonably obligated to pay under the undisputable facts shown by the record before us; therefore the reason for the rule of binding declared value is absent and the rule is inapplicable to this proceeding."

The taxable entity, the bankrupt, is not relieved of its obligation to pay the tax. The debt is not dischargeable.

Bankruptcy Act, Section 17-a. The new entity, the Trustee representing creditors, who were not parties to the transactions between the federal government and the bankrupt, and who are entirely innocent, should not be required to relieve the bankrupt of this burden.

But this view of the appellate court overlooks the principle that the taxpaying entity changes when bankruptcy commences. The Trustee in Bankruptcy, while successor to the title to the property of the bankrupt by operation of law, primarily represents the unsecured creditors. *In re American Fidelity Corp.* (D. C. S. D. Cal.), 28 Fed. Supp. 462, 40 A. B. R. (N. S.) 379. This subject is tersely summarized in the opinion of Judge McCormick in the District Court in the instant case.

> "Here we find a bankrupt corporation at no time subsequent to May 13, 1940, 'carrying on or doing business,' but where all of the activities of its trustee are directed to the liquidation and distribution in accordance with the ordinary processes of the Bankruptcy Act. In such a case, under the express authority of Section 64-(a) of the Bankruptcy Act an obviously arbitrary and fictitious value as the basis of a tax against the trustee is not conclusive against him. By reason of the broad investiture of power under the Bankruptcy Act the Bankruptcy Court cannot be precluded from ascertaining and determining the amount of the capital stock tax, if any, that is assessable and chargeable against the bankrupt estate because some entity, unauthorized by the court, has at some earlier time made a commitment with respect to the capital value of the corporation when the company was carrying on and doing business. New Jersey v. Anderson, 203 U. S. 483, 17 Am. B. R. 63."

POINT 3.

Any Estoppel That Might Attach to the Bankrupt Would Not Necessarily Attach to the Trustee or the Creditors, Since They Were Not Parties to the Transaction Out of Which the Estoppel Arose.

The bankrupt corporation formally declared a capital stock value. The Commissioner adjusted this to a lower figure. If the bankrupt is estopped to question the figure arrived at, is the Trustee, representing creditors also estopped? We think not. The Trustee and the creditors were not parties to the transaction out of which the estoppel might arise. They had no part in the declaration of value. Estoppel affects only the immediate parties to the transaction and their privies. *Roper v. Smith*, 45 Cal. App. 302. With respect to the Trustee's right to contest claims for taxes levied against a bankrupt's property, the doctrine of estoppel is inapplicable since there is no privity between the Trustee and the bankrupt. The Trustee acquired title to the property of the bankrupt by operation of law only. *In re Gustav Schaeffer Co.* (C. C. A. 6), 103 Fed. (2d) 237, 39 A. B. R. (N. S.) 617. The Trustee represents the general creditors and in this capacity may assert claims, defend against them, avoid preferences, and collect assets where the bankrupt, if bankruptcy had not intervened, would be estopped. *In re Kessler* (C. C. A. 2), 186 Fed. 127, affirmed, *Merchants' Natl. Bk. v. Secton*, 228 U. S. 634, 57 L. Ed. 998, 30 A. B. R. 278.

POINT 4.

The Doctrine of Res Judicata Has No Application Here, Either as to the Bankrupt or the Trustee.

This appears to be obvious, since neither the bankrupt nor the Trustee participated in any hearing before any federal judicial, or *quasi*-judicial agency. The case of *Arkansas v. Thompson, supra*, would seem not to apply. Even though the bankrupt were bound by *res judicata*, this would not restrict the Trustee nor the creditors. *Res judicata* affects only the parties themselves to the suit or proceeding.

Edmonds v. Glenn-Colusa Irrigation District, 217 Cal. 436.

POINT 5.

Once Bankruptcy Intervened the General Creditors, Represented by the Trustee, Had the Right to a Determination by the Bankruptcy Court as to Whether or Not the Previously Declared Capital Stock Value or the Subsequently Adjusted Value Was Excessive, Irrespective of Whatever Action May or Could Have Been Taken by the Bankrupt Under Applicable State or Federal Law, Short of an Actual Prior Determination by Another Court That Would Be Binding Upon the Trustee.

The cases supporting this doctrine are numerous and are collected in *Collier on Bankruptcy*, 14th Ed., Vol. 3, 2149, Note 25:

In re Seaver-Howland Press, Ref., Mass., 16 A. B. R. (N. S.) 227;

Comacho v. Int. Express & Foundry Co. (D. C. Porto Rico), 48 A. B. R. 317;

In re Gustav Schaefer Co. (C. C. A. 6), 103 Fed. (2d) 237, 39 A. B. R. (N. S.) 617;

In re E. C. Fisher Corp. (D. C. Mass.), 229 Fed. 316, 36 A. B. R. 509;

In re Raflowitz (D. C. Conn.), 37 Fed. Supp. 202, 45 A. B. R. (N. S.) 11;

In re R. Suarez & Co. (D. C. Porto Rico), 48 A. B. R. 316;

In re Otto Freund Arnold Yeast Co. (D. C. N. Y.), 178 Fed. 305, 24 A. B. R. 458;

County of Henderson v. Wilkins (C. C. A. 4), 43 Fed. (2d) 670, 16 A. B. R. (N. S.) 359;

In re Willett-Baker Lumber Co. (D. C. E. D. N. Y.), 31 Fed. Supp. 130, 41 A. B. R. (N. S.) 339.

POINT 6.

A Prime Purpose of the Bankruptcy Act Is to Provide Machinery Whereby Bankrupt Estates Can Be Administered Economically and Closed Promptly.

Unless the Bankruptcy Court can invoke the powers apparently granted them for this purpose by Sections 2-a-(4), 64-a-(4) and 62-a of the Bankruptcy Act, this objective cannot be attained. Under the broad powers granted by these sections, as we construe them, the delays incident to the ordinary procedure governing the collection of taxes are thus avoided and the early settlement of the bankrupt's estate is greatly facilitated.

Cohen v. United States (C. C. A. 1), 115 Fed. (2d) 505, 44 A. B. R. (N. S.) 489;

In re Sheinman (D. C. E. D. Pa.), 14 Fed. (2d) 323, 8 A. B. R. (N. S.) 623;

In re Universal Rubber Products Co., 25 Fed. (2d) 168, 11 A. B. R. (N. S.) 183, affirmed (C. C. A. 3), 28 Fed. (2d) 253, 12 A. B. R. (N. S.) 698;

In re W. P. Williams Oil Corp. (D. C. W. D. Ky.), 265 Fed. 401, 45 A. B. R. 278;

In re Clayton Magazines (C. C. A. 2), 77 Fed. (2d) 852, 29 A. B. R. (N. S.) 97.

POINT 7.

A Determination After Hearing by a Duly-Constituted Tax Board or Agency, Where the Trustee or the Creditors as a Whole Were Not Parties, Is Not Conclusive on the Bankruptcy Court.

The cases on this subject are collected in *Collier on Bankruptcy*, 14th Ed., Vol. 3, p. 2147, Notes 13 and 14:

In re Denver & Rio Grande R. Co. (D. C. Col.), 23 Fed. Supp. 298, 37 A. B. R. (N. S.) 156;

In re Seaver-Howland Press (Ref. Mass.), 16 A. B. R. (N. S.) 227;

In re Becker (Ref. N. J.), 12 A. B. R. (N. S.) 732;

Dickinson v. Reilly (C. C. A. 8), 86 Fed. (2d) 385, 32 A. B. R. (N. S.) 279;

In re Thermiodyne Radio Corp. (D. C. Del.), 26 Fed. (2d) 716, 12 A. B. R. (N. S.) 192;

State of New Jersey v. Anderson, 203 U. S. 483, 51 L. Ed. 284, 17 A. B. R. 63;

Contra: Kelly v. United States (C. C. A. 9), 90 Fed. (2d) 73, 34 A. B. R. (N. S.) 191.

POINT 8.

The Supreme Court Has Held That a Sale Free of the Lien of a Tax Claim May Be Held in Bankruptcy and the Taxing Agency Remitted to the Proceeds of the Sale for the Collection of the Taxes.

So held in the case of *Van Huffel v. Harkleroad*, decided Dec. 7, 1931, 284 U. S. 225, 76 L. Ed. 256, 18 A. B. R. (N. S.) 730. There the Court stated:

> "No good reason is suggested why liens for state taxes should be deemed to have been excluded from the scope of this general power to sell free from encumbrances. Section 64 of the Bankruptcy Act grants to the court express authority to determine 'the amount or legality' of any tax. To transfer the lien from the property to the proceeds of its sale is the exercise of a lesser power; and legislation conferring it is obviously constitutional. Realization upon the lien created by the state law must yield to the requirements of bankruptcy administration."

We see no conflict between this case and the *Arkansas* case. The earlier case distinctly states that the ***amount*** as well as the *legality* of taxes may be determined by the Bankruptcy Court. The earlier case is not overruled or distinguished in the *Arkansas* case. It is not even referred to.

POINT 9.

The Declared Value of Capital Stock May Not Be Arbitrary and Fictitious, but Should Have a Fair Relationship With the Actual Value.

The federal government may contend that the capital stock on which the tax is imposed bears no relationship to the actual value of such stock and was not intended to bear any such relationship. In other words, each individual taxpayer has a right to arbitrarily declare the value regardless of actual value; and can make the best guess possible as to the future of his business and then based upon that guess to arbitrarily declare a value for the stock which would place his combined capital stock tax and excess profits tax at a minimum, which valuation would in many cases bear no relationship to the actual value. This contention is exploded in the case of *Kentucky Fire Brick Co. v. Glenn*, D. C., W. D., Ky., 34 Fed. Supp. 35. In that case it was held that the taxpayer should make the declaration of value consistent with the facts, with reasonable latitude allowed for difference in judgment, and should exercise good faith in the declaration, since "value" has a definite meaning which is radically different from selecting a figure at will. It was further held that the purpose of the statute imposing capital stock taxes upon corporations was to impose a tax based on fair and reasonable value rather than upon arbitrary value. Also that the restriction that the value first declared could not be changed, did not apply and was not conclusive if the taxpayer acted arbitrarily or fraudulently in declaring such value with the result that the tax was based upon a false and fictitious value.

VI.
Conclusion.

We contend that false or excessive taxes should not be allowed against bankrupt estates, unless the Bankruptcy Act is so framed that the Bankruptcy Court is powerless to overcome the evil. We maintain that our exposition of the subject above, shows that it is not. The Bankruptcy Court, in its exclusive control over the administration of the estate, can either decide these matters itself, or remit the trustee to a state court or *quasi*-judicial agency, or another federal court, or *quasi*-judicial agency, of competent jurisdiction, to make the determination. *In re Baldwin,* 291 U. S. 610, 78 L. Ed. 20, 24 A. B. R. (N. S.) 487; *Thompson v. Magnolia Petroleum Co.,* 309 U. S. 478, 84 L. Ed. 876, 42 A. B. R. (N. S.) 216; *In re American Fidelity Corp.* (D. C. S. D. Cal.), 28 Fed. Supp. 462, 40 A. B. R. (N. S.) 379. We do not see anything in the *Arkansas* case to the contrary. Nor should any state government, or the federal government insist upon the collection of false and excessive taxes. Governments expect their citizens to deal fairly with them in the payment of taxes. Governments should likewise deal fairly with its citizens in the assessment and collection of taxes, especially where this is sought from the beneficiaries of bankrupt estates, the creditors, who are innocent parties and have not had any participation in the transactions between the debtors and the taxing agencies.

United States v. Middle States Oil Co. (C. C. A. 8), 18 Fed. (2d) 231.

In view of the conflict of authority, and the importance of the questions involved, both to state governments and the federal government, and the taxpayers of the nation, we urge this Court to take over this case by a writ of certiorari and settle the proper rules to govern the matters we have discussed.

We submit that, if the writ is granted, the ultimate decision should reverse the judgment of the Ninth Circuit Court of Appeals and uphold the decision of the District Court for the Southern District of California.

Dated at Los Angeles, California, this 18th day of December, 1941.

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